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No. 87-1160

IN THE
Supreme Court of the United States
OCTOBER TERM, 1987

DUQUESNE LIGHT COMPANY

and

PENNSYLVANIA POWER COMPANY,
Appellants,

v.

DAVID M. BARASCH,
CONSUMER ADVOCATE, *et al.*,
Appellees.

On Appeal from the Supreme Court of Pennsylvania

BRIEF OF INDUSTRIAL ENERGY CONSUMERS OF PENNSYLVANIA; ELECTRICITY CONSUMERS RESOURCE COUNCIL AND AMERICAN IRON AND STEEL INSTITUTE AS AMICUS CURIAE IN SUPPORT OF APPELLEES

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QUESTION PRESENTED

Do the Fifth and Fourteenth Amendments require state ratemaking agencies to allow recovery of or the return on prudently incurred investments (including but not limited to cancelled electric generating units) without consideration of whether those investments constitute used and useful utility property?

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The Industrial Energy Consumers of Pennsylvania (IECPA), the Electricity Consumers Resource Council (ELCON), and the American Iron and Steel Institute (AISI) hereby submit their Brief Amicus Curiae in Support of Appellee David M. Barasch, Consumer Advocate, et al. and of the decision by the Supreme Court of Pennsylvania.[1]

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[1] IECPA, ELCON and AISI have obtained the written consents of all parties to this case. The written consents have been filed with the Clerk of this Court.

INTEREST OF AMICUS CURIAE

IECPA is a statewide group of energy intensive industrial consumers of electricity.[2] IECPA members employ approximately 130,451 Pennsylvanians and consume 25% of the industrial electricity purchased in the Commonwealth. IECPA members operate 187 facilities in Pennsylvania, including several within the service territory of the Appellants, Duquesne Light Company and Pennsylvania Power Company.

[2] The members of IECPA are:

Air Products & Chemicals, Inc.
Airco Industrial Gases
Allegheny Ludlum Steel Corporation
Allentown Cement Company
Allied Corporation
Appleton Papers, Inc.
Armco Advanced Materials Corporation
Babcock & Wilcox Company
The J. E. Baker Company
Bethlehem Steel Corporation
Cabot Corporation
Carpenter Technology Corporation
Caterpillar Tractor Company
Cooper Industries
Corning Glass Works
Cressona Aluminum Company
Dana Corporation
Franklin Steel Company
General Battery Corporation
International Paper Company
Hercules Cement Company
Hershey Foods Corporation
Jessop Steel Company
Liquid Air Corporation
Lukens Steel Company
M G Industries
National Forge Company
New Jersey Zinc Company, Inc.
Owens-Illinois, Inc.
PPG Industries, Inc.
The Procter & Gamble Paper Products Co.
Rohm and Haas Company
Standard Steel
Sun Refining & Marketing Company
Union Carbide Corporation
USX Corporation
Washington Steel Corporation

ELCON is a national organization of 17 energy intensive industrial consumers of electricity which employ more than 800,000 people. ELCON members operate more than 650 different facilities in 49 of the 50 states and, in addition, have sizeable operations in numerous foreign countries. The electricity consumption by ELCON members exceeds the total electricity sales of 36 of the 50 states. ELCON member companies produce a wide range of products, including steel, chemicals, industrial gases, glass, motor vehicles, electronic equipment, appliances, textiles and food.[3]

AISA is the principal trade association of the domestic steel industry. Its forty-three domestic member companies account for more than eighty percent of the raw steel production capability in the United States.[4] The

[3] The members of ELCON are:

Air Products and Chemicals, Inc.
American National Can
Anheuser-Busch Companies, Inc.
Armco
Bethlehem Steel Corporation
Cone Mills Corporation
Corning Glass Works
Dow Chemical U.S.A.
E.I. duPont deNemours & Company
FMC Corporation
General Motors Corporation
Hercules Incorporated
Hershey Foods Corporation
Owens-Corning Fiberglass
PPG Industries, Inc.
A. E. Staley Manufacturing Company
Union Carbide Corporation

[4] The domestic member companies of AISI are:

Acme Steel Company
Armco Inc.

cost of electricity to AISI members may constitute as much as forty percent of the cost of a steel mill product,

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Atlantic Steel Company
Avesta Stainless Inc.
The Babcock & Wilcox Company
Bethlehem Steel Corporation
Berg Steel Pipe Corporation
California Steel Industries, Inc.
Carpenter Technology Corporation
Cleveland-Cliffs Inc.
Copperweld Steel Corporation
Electralloy Corporation
A. Finkl & Sons Co.
Geneva Steel Company
Georgetown Industries, Inc.
Gulf States Steel, Inc.
M. A. Hanna Company
Harsco Corporation
Hi Specialty America
Inland Steel Industries, Inc.
Earle M. Jorgensen Company
Laclede Steel Company
Lone Star Technologies, Inc.
LTV Steel Company
Lukens Inc.
McLouth Steel Products Corporation
National Steel Corportaion
North Star Steel Company
Oblebay Norton Company
Raritan River Steel Company
Rhode Island Forging Steel, Inc.
Rome Strip Steel Company, Inc.
Rouge Steel Company
Sandvik Inc.
Sharon Steel Corporation
Sharon Tube Company
Shenango Incorporated
The Timken Company
USS, A Division of USX Corporation
Valley-Vulcan Mold Company
Weirton Steel Corporation
Wheatland Tube Company
Wheeling-Pittsburgh Steel Corporation

making the steel industry one of the most energy-intensive industries in the country.

Individual IECPA, ELCON and AISI members, either directly or through industrial intervention groups, have participated in numerous rate cases filed by utilities over the last fiifteen years, including cases in which the issue of a return of or on prudent investments, which have not proven to be used and useful for producing electric service, has been addressed. In no such case has the utility been entitled to a return of or on its investment as a matter of right. Rather, the respective state or the ratemaking agency of the state has always had the discretion to determine whether the utility is entitled to a return of or on prudent investment based on all the facts presented, including whether the investment produced used and useful property.

IECPA, ELCON and AISI have a direct and substantial interest in this case. Each organization seeks to assure that adequate and secure long-term supplies of electricity will be available in Pennsylvania and the nation at equitable and competitive prices. However, the development of equitable and competitive prices for electricity service to ratepayers must be based upon valid cost of service principles. IECPAs, ELCON's and AISI's interests are twofold in that their members must have long-term supplies of electricity available in order to produce their respective products. However, the assurance of a long-term supply of electricity must be at a price which enables their members to produce competitively priced products. An excessive supply of electricity at excessive prices will not permit their members to maintain their competitive positions in the marketplace.

The position advocated by the Appellants and the amicus curiae supporting the Appellants would create a constitutional entitlement to the recovery of or the return on any prudent investment made by an electric

utility without consideration of whether that investment resulted in used and useful public utility property providing actual utility service to customers. It would eliminate the flexibility and discretion which states have had to decide whether a utility should be permitted to recover a return of or on investments which may have been prudent but which have not produced used and useful property. The retention of that flexibility and discretion is essential to the proper balancing of ratepayer and shareholder interests. Appellants seek to establish a constitutional right for utilities to recover a return of and on investments which a private enterprise in the competitive marketplace would have no such opportunity to recover. Thus, the principle that regulation "mirror" the operation of competitive markets would be shattered.

Removal of the "used and useful" standard, as advocated by Appellants and their amici would create a "prudence-only" standard for the recovery of or on utility investment. As members of energy intensive industrial intervention groups, IECPA, ELCON and AISI members have participated regularly in a substantial number of rate cases filed by utilities over the last fifteen years. That experience confirms their serious concerns with a prudence-only standard because one of the few checks state ratemaking agencies have been able to apply on utility rate increases is the requirement that a prudent utility investment should also result in the production of used and useful utility property. A "prudence-only" standard would remove this check. Under current law, if a prudent investment fails to produce used and useful utility property, a state has discretion to deny a return of or on that investment. States require such discretion to properly balance the interests of utilities and consumers. A constitutional entitlement to the recovery of or on all prudent utility investment could cause greater rate increases than are necessary or appropriate to fairly compensate utility investors. Such increases would, of course, be contrary to the public interest.

The argument set forth below will show that the Pennsylvania Public Utility Code, as applied to Appellants in this case, has not effected a taking of property in violation of the Fifth and Fourteenth Amendments to the Constitution.

COUNTERSTATEMENT OF THE CASE

IECPA, ELCON and AISI adopt the counterstatement of the case as set forth in the Brief of Appellee David M. Barasch, Consumer Advocate.

However, IECPA, ELCON and AISI must clarify the mischaracterizations by Appellants and their amici of two decisions by the Pennsylvania Public Utility Commission: *Investigation of the Need for Additional Electric Generating and Transmission Facilities,* Investigation Docket No. 138, 46 Pa. P.U.C. 23 (1972), and *Pennsylvania Public Utility Comm'n v. Metropolitan Edison Co.,* Rate Investigation Docket No. 64, 47 Pa. P.U.C. 56 (1973). Neither of these decisions imposed an affirmative requirement on the Appellants, or any other jurisdictional electric utility in Pennsylvania, to invest in additional electric generating stations.

The Commission instituted Investigation Docket No. 138 due to the threat of electric power shortages and the need to stimulate electric power companies "in the development of plans for increasing generating capacity to meet anticipated load growth and future demands." 46 Pa. P.U.C. at 23. The investigation was necessitated because load growth had exceeded certain utility companies' inaccurate forecasts and because a "conservative attitude" on the part of some utilities resulted in a serious installed capacity deficiency situation. *Id.* at 24.

However, as the Commission sought to rectify the problem, it specifically left to each utility the determination of whether that specific utility needed additional capacity. It left to each utility the estimates of customer demand

requirements on which any determination of need for additional capacity would be based. The Commission also clearly left to each utility company the decision as to whether sufficient reserve capacity should be achieved through new construction, the importation of electricity from other sources, or from conservation.[5] In the event a specific utility concluded it needed additional capacity based on its estimates of consumer demand and its evaluation of the alternatives available for meeting that demand, the Commission also left to each utility the development of a generating capacity expansion plan, including the schedules for generating plant and transmission line additions, and the cost estimates for construction of new generating plants. *See* Ordering Paragraphs at 46 Pa. P.U.C. at 26-27.

The Commission never directed or required the Appellants to develop, plan for, or invest in the four cancelled nuclear plants at issue in this case. The most the Commission ever indicated to the utility industry as a whole was that it "wanted 2,000 megawatts of combustion turbine capacity immediately." *Id.* at 25. After the Commission's investigation, the Appellants, based upon their own projections of capacity needs, load growth, and the effect of conservation, chose to pursue the capacity planning schedule which resulted in the planning and cancellation of the four nuclear units in this case. The Commission never "required" the Appellants to construct the facilities which are the subject of this case.

In the context of rate relief requests by individual utilities in the early 1970s, the Commission continued to indicate its desire for specific individual utilities to continue construction of electric generating capacity where necessary. *See e.g., Pennsylvania Public Utility Comm'n*

[5] Even as early as this 1972 investigation, the Commission noted the developing trend to conserve the use of electricity and the implications that such conservation would have on the demands for electric power. 46 Pa. P.U.C. at 26-27.

v. Metropolitan Edison Co., Rate Investigation Docket No. 64, *supra*. However, these Commission desires were expressed in the context of base rate increase requests by specific utilities after such utilities had already made their decision to invest in the construction of generating capacity based upon their own specific capacity plan forecasts and specific load growth estimates. As individual utilities approached the Commission for rate relief, one reason relied on by the Commission in granting the requested relief was the Commission's distinct concern with the sufficiency of the electric generating capacity in the Commonwealth. *Id* at 59. The Commission did not, however, in *Metropolitan Edison* or in any other rate case actually require a utility to engage in a particular capacity expansion plan or to construct a particular type of capacity. Furthermore, in no rate proceeding involving Appellants did the Commission endorse the construction program resulting in the cancelled plants at issue here.

A review of the Pennsylvania Public Utility Code, 66 Pa. C.S. § 101, *et seq.* (hereinafter "Code") indicates that the Pennsylvania Public Utility Commission does not have the statutory authority to require investment in generating plants. The Code merely establishes that every public utility must furnish and maintain adequate, efficient, safe, and reasonable service and facilities. 66 Pa. C.S. § 1501. Thus, the decision by the Appellants to pursue the capacity expansion plan in question constituted a voluntary act on their part based upon their own respective capacity plan forecasts and load growth scenarios. Any references by the Appellants, or the amici supporting Appellants, to the proposition that the Commission required the investments subject to this case should be ignored.

SUMMARY OF ARGUMENT

The Fifth and Fourteenth Amendments to the United States Constitution do not require states to allow recovery of or on prudently incurred investments by regulated utilities without any consideration of whether those investments produced used and useful utility property. Section 1315 of the Pennsylvania Public Utility Code, which denies recovery of or on an investment which is not used and useful, is consistent with this Court's application of the Fifth and Fourteenth Amendments to regulated industries in the line of cases proceeding from *Smyth v. Ames*, 169 U.S. 466 (1898) through *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) to *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

By creating a constitutional entitlement to utility investor recovery of or on prudent investment in property which does not produce used and useful public service, this Court would upset the long-established principle of public utility regulation that regulation should mirror the competitive private marketplace in an otherwise monopolistic business. IECPA, ELCON and AISI members compete in the private economy and are well aware of its competitive nature. The United States economy is organized on the decentralized lines of private property and private enterprise such that competition is relied upon to promote the public welfare and the market is the central institution regulating economic activity.[6] However, in some industries, like the electric utility industry, competition has not traditionally been effective and regulation by the government may be necessary to protect the public interest. As noted by Walter Adams, "Here the visible hand of public regulation was to replace the invisible hand of Adam Smith in order to protect consumers against extortion of charges, restrictions of output,

[6] Charles F. Phillips, Jr., *The Regulation of Public Utilities* (1984).

deterioration of service, and unfair discrimination."[7] In the private unregulated economy, the invisible hand of the market usually does not provide a return of, or on, investments, however prudent, which turn out to be wrong by not producing property which is used and useful in making products or services consumers wish to purchase. Competition prevents non-monopolists from raising their prices above those of their competitors who did not make comparable investments. The visible hand of public regulation should not provide an affirmative constitutional entitlement to the recovery of such prudent, yet uneconomic, investments.

Such an entitlement would create an undue preference for the utility investor over the investor in the private competitive marketplace. It would not only shift the balance in favor of the utility investor over the ratepayer and the private investor, but would also upset the balance inherent in the American economy between regulated entities and nonregulated entities. The former would recover *any* prudent investment, with the cost of prudent but uneconomic investment borne by their customers and not by their shareholders. Competitive private enterprises have no such guarantee and the cost of their prudent, yet uneconomic investments are usually borne entirely by their shareholders. No rational reading of this Court's teachings in the *Hope* and *Permian Basin* cases would conclude that this Court intended the former as a result.

During the Court's application of the Fifth and Fourteenth Amendments to regulated industries in the context of these three cases, the utility investor has never been granted a constitutional entitlement to the recovery of all prudent investments without a consideration of other relevant factors. Those factors include, but are not limited to, the ability of the utility to maintain its finan-

[7] Walter Adams "The Role of Competition and the Regulated Industries", 48 American Economic Review, 527 (1958).

cial integrity, the ability of the utility to attract necessary capital, fair compensation to investors for the risks they have assumed, and protection of the relevant public interest both at the present time and in the foreseeable future. *Permian*, 390 U.S. at 792. These factors are evaluated in the context of the total rate case effect of the state ratemaking body's decision and the end result of that case. *See Hope*, 320 U.S. at 602-603.

No constitutional taking of property can exist when the total rate case effect and the end result of that case permits the utility to operate successfully and profitably. Such a result indicates that a proper balancing has been achieved between the interests of ratepayers and investors consistent with this Court's teachings in *Hope*, *Permian Basin*, and *FPC v. Memphis Light, Gas & Water Division*, 411 U.S. 458 (1973). Not only have Appellants continued to operate successfully and profitably, but each has continued to engage in a substantial construction program after the Pennsylvania Supreme Court's decision to deny a recovery of or on the prudently incurred investment in cancelled nuclear generating units.

The Appellants and the amici supporting Appellants misinterpret and misapply the intent and teachings of the *Hope* and *Permian Basin* cases. In those cases, this Court did not create an additional constitutional right guaranteeing a recovery of or on all prudent investments made by utility investors. Rather, those cases sought to remove the courts from intervention in the minutia of regulatory rate case proceedings and to have courts focus, instead, on the issue of whether the regulatory decision permitted the utility to operate successfully. If this end result is obtained, then a utility should not have a complaint because the interests of ratepayers and investors have been reasonably balanced.

This Court's dismissal of comparable proceedings indicates that the used and useful principle as applied by the

Pennsylvania Supreme Court was not overridden by *Hope* and that utility investors have no constitutional right to the recovery of or on all prudent investments.

Through a dismissal for want of a substantial federal question, this Court refused to reverse on the merits Pennsylvania and other states' denial of cost recovery on utility investment in nuclear power plants which have been out of service for extended periods due to nuclear accidents. *Pennsylvania Electric Co. v. Pennsylvania Public Utility Comm'n*, 509 Pa. 324, 502 A.2d 130 (1985), *appeal dismissed sub nom. Metropolitan Edison Co. v. Pennsylvania Public Utility Comm'n*, 476 U.S. 1137 (1986). *See also Jersey Central Power & Light Co. v. Board of Public Utilities*, 466 U.S. 947 (1984). The Court dismissed several other cases, some of which involved the same cancelled nuclear plants subject to this case. *Cleveland Electric Illuminating Co. v. Public Utilities Comm'n*, 4 Ohio St.3d 107, 447 N.E.2d 746, *appeal dismissed*, 464 U.S. 802 (1983); *Cleveland Electric Illuminating Co. v. Public Utilities Comm'n*, No. 82-165 (Ohio, July 7, 1982), *appeal dismissed*, 459 U.S. 1094 (1983); *Office of Consumers' Counsel v. Public Utilities Comm'n*, 67 Ohio St.2d 153, 423 N.E.2d 820 (1981), *appeal dismissed sub nom, Cleveland Electric Illuminating Co. v. Office of Consumers' Counsel*, 455 U.S. 914 (1982); *Northern Indiana Public Service Co. v. Citizens Action Coalition of Indiana, Inc.*, 485 N.E.2d 610 (Indiana 1985), *appeal dismissed* and *cert. denied*, 476 U.S. 1137 (1986).

Therefore, no basis exists in the context of economic theory, in this Court's teachings in *Hope* and *Permian Basin*, or in this Court's treatment of similar issues, to create a constitutional entitlement for the recovery of or on all prudent utility investments irrespective of whether those investments ever produced used and useful utility property.

ARGUMENT

I. The Pennsylvania Supreme Court's Application of The Used And Useful Principle Did Not Result In An Unconstitutional Taking Of The Appellant's Property Because The Fifth And Fourteenth Amendments Do Not Entitle Regulated Utilities To Recovery Of Or On Prudently Incurred Investments Without Consideration Of Other Factors, Including, But Not Limited To, The Used And Useful Principle.

Section 1315 of the Code reads as follows:

> § 1315. Limitation on consideration of certain costs for electric utilities
>
> Except for such nonrevenue producing, nonexpense reducing investments as may be reasonably shown to be necessary to improve environmental conditions at existing facilities or improve safety at existing facilities or as may be required to convert facilities to the utilization of coal, the cost of construction or expansion of a facility undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public. Except as stated in this section, no electric utility property shall be deemed used and useful until it is presently providing actual utility service to the customers. 66 Pa. C.S. § 1315.

The Pennsylvania Supreme Court held that Section 1315 of the Code prohibits an electric utility from recovering the costs of cancelled plants from ratepayers, either by making such costs part of its rate base or by converting them into operating expenses through amortization. To have reached any other conclusion, the Pennsylvania Supreme Court would have had to treat as surplusage the portion of Section 1315's proscription which states, ". . . nor otherwise included in the rates charged by the

electric utility." *Barasch v. Pennsylvania Public Utility Comm'n*, 532 A.2d at 332. Section 1315 specifically defines "used and useful" as property which is presently providing actual utility service to customers. As a result, investment in a cancelled plant which never provided actual utility service had to be excluded from rate base and not charged to ratepayers through an amortized operating expense. Clearly, the Pennsylvania Supreme Court applied the letter of the law to the Appellants consistent with Section 1934 of the Statutory Construction Act of 1972, 1 Pa. C.S. § 1934. *Id.* at 332.

Appellants now challenge the constitutional validity of the statute itself, as well as other "unspecified ratemaking legislation."[8] In order for that constitutional challenge to be successful, this Court would have to find that the Fifth and Fourteenth Amendments *require* states to allow recovery of or on prudently incurred investments (including, but not limited to, cancelled electric generating units) without any consideration of whether those investments constitute used and useful property. The establishment of such a constitutional entitlement to the recovery of all prudent investments would be directly contrary to the economic rationale underlying utility rate regulation and in direct contravention of this Court's definition of the rights of utility investors.

A. *Appellants' Interpretation Of Hope And Permian Basin Violates The Basic Economic Tenets of Regulatory Law Which Are Intended To Mirror The Competitive Marketplace.*

Rate regulation is, in theory and in practice, hopefully, the substitute for competition. *Jersey Central Power & Light v. FERC*, 810 F.2d 1168, 1190 (D.C. Cir. 1987)

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[8] *See* Appellant's Brief at pp. 2-3, footnote no. 2, for an explanation of this term.

(Starr, concurring). Appellant's interpretation of *Hope* and *Permian Basin* creating a prudence-only standard would prevent regulation from properly substituting for competition. In a competitive marketplace, investors have no constitutional entitlement to a return of or on prudent investments which fail to produce economic results. If rate regulation is performing its function as a substitute for competition, the regulated entity, likewise, should not be afforded a constitutional entitlement to a return of or on prudent investments which never provide an economic benefit to ratepayers. *Id.* at 1190. Judge Starr's characterization of rate regulation as a substitute for competition and his caution to examine both ends of the continuum—both the prudence of the investment and whether the end result of the investment was used and useful—forms the crux of this amicus curiae brief in opposition to the prudence-only standard advocated by Appellants and the amici supporting Appellants.

The used and useful principle operates as a restraining principle, reminding utility managers that they must assume the risk of economic forces working against an investment which is prudent at the time it is made. 810 F.2d 1190, fn.1. Without this "reminder" to utility managers, no meaningful check would exist on managers' decisions to plan and build excess generating capacity and automatically pass the costs of that capacity on to ratepayers. While prudence is a relevant issue in the process of striking a reasonable balance in rate setting for public utilities, the used and useful rule is another safeguard. The prudence rule looks to the time of the investment, whereas the used and useful rule looks to a later time. These two principles are designed to assure that the ratepayers, whose property might otherwise be taken by regulatory authorities through approval of utility rate increases, will not necessarily be saddled with the results of management's defalcations or mistakes, or as a matter of simple justice, be required to pay for that

which provides the ratepayers with not discernible benefit. *Id.* at 1190.

Without application of the used and useful principle to offset the application of the prudence standard, the Constitution would protect utility investors entirely from the business risks experienced daily in the free market system. These business risks are a component of the ratemaking process when regulatory bodies establish an authorized overall rate of return for the utility. A business in the private sector must constantly deal with the risk of investing in too much capacity when the market does not meet expectations due to economic factors beyond management's control. Absent a monopoly, a private business cannot automatically increase prices to its customers to recover a prudent but uneconomic expenditure, since customers will switch to competitors' products. IECPA, ELCON and AISI are in full agreement with Judge Starr's statement that utilities should not be exempt from comparable competitive economic forces. *Id.* at 1191.

In the private competitive marketplace, prudence does not guarantee a company economic success or a return of or on its investment. Numerous private "prudent" companies have gone bankrupt because of investments which were prudent when made but which turned out to be poor business or economic decisions. The regulatory system already provides some relief to utilities from the threat of bankruptcy for making uneconomic business decisions. This Court should not ignore economic reality and entitle utility investors to a return of or on investment which does not produce used and useful utility property. If such an investment were made in the private sector, no such entitlement of a return would exist. Individual members of IECPA, ELCON and AISI constantly make prudent business decisions with the expectation that the decision will represent a valid economic and business judgment. Unfortunately, investments do not always

achieve their desired expectations and shareholders must absorb any resulting economic loss. This Court should not place utility investors in a protective cocoon which insulates them from valid business risks experienced by unregulated entities.

Moreover, denial of recovery of a prudent investment not used and useful for service to customers does not constitute a taking of property by the state. No property is taken since the private competitive marketplace itself denied any return. No property right exists entitling a regulated utility to recovery in excess of that provided in the private, competitive, unregulated economy. *Market Street Railway Co. v. Railroad Comm'n of Calif.*, 324 U.S. 548, 566-67 (1945) (recovery not required where market forces, not the state, reduces the value of property). Here, Appellants' prudent investments were rendered uneconomic, and the plants cancelled, as a result of market forces, not state action. Pennsylvania's decision to deny Appellants a recovery of or on property that was not used and useful merely confirmed the operation of market forces. The purposes of regulation is to deny utilities monopoly profits in excess of that which a competitive marketplace would permit. Here, Appellants attempt to manipulate the regulatory system and this Court's prior decisions to compel a recovery in excess of that which a competitive economy would allow. This Court should not be manipulated so as to create a constitutional standard which would mandate the potential of monopoly profits for the utility industry far in excess of what could be earned in the competitive marketplace.

B. *The Decisions By This Court And The Lower Federal Courts Before And After The Hope And Permian Cases Confirm That The Continued Utilization Of The Used And Useful Principle In Ratemaking Is Consistent With This Court's Holdings In Hope And Permian.*

The Appellants and amici supporting Appellants rely upon a misapplication of this Court's teachings in the *Hope* and *Permian Basin* cases. Neither case held that utility investors have a constitutional entitlement to the recovery of all prudent investments without any consideration of the used and useful principle. Appellants seek to distort the Court's holdings in these cases by ignoring the "end result" of the case and by overturning the Court's opinion that "It is not theory but impact of the rate order which counts." *Hope*, 320 U.S. at 602.

Hope and *Permian Basin* clarified the Court's approach to utility rate cases and utility investor expectations but did not override or overturn the used and useful principle. In fact, *Hope* did not discuss the used and useful principle when outlining this Court's application of the "just and reasonable" ratemaking standard.

In *Hope*, the Court refused to bind the Federal Power Commission to the use of any single formula or combination of formulae in determining rates primarily because the ratemaking function involved the making of pragmatic adjustments. 320 U.S. at 602; *see also FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942). When a ratemaking order is challenged in the courts, the question under *Hope* is whether the order "viewed in its entirety" meets the requirements of the statutory standard of "just and reasonable rates." The result which is obtained is the important factor and not the method employed in reaching that result. *Id.* The Appellants and supporting amici in this proceeding would have this Court focus entirely on one ratemaking item in a com-

plex rate proceeding which achieved the all important *result* of just and reasonable rates.

In both *Hope and Permian Basin*, the Court held that if the total effect of the rate order cannot be said to be unjust and unreasonable, then judicial inquiry should end. Even if the methods employed to reach a certain result contain infirmities, the Court would not necessarily conclude that the total effect of the rate order was inappropriate. *Id.* The total effect of the rate order subject to this appeal on Duquesne Light Company resulted in an 11.6% overall rate of return, a 16.14% return on common equity, an annual base rate increase in excess of $105 Million, and total annual revenues in excess of $800 Million. (App. 19C, 93C, 126C). For Duquesne Light Company to contend that the disallowed $3.5 Million annual amortization for the cancelled plant costs violated this Court's teachings in *Hope* borders on the ridiculous. While *Hope* recognized the fixing of just and reasonable rates involves a balancing of the investor and consumer interests, the Duquesne Light Company investor interests in financial integrity were clearly served even with the $3.5 Million annual amortization disallowance.

The *Hope* court stated, "Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid even though they might produce only a meager return on the so called 'fair value' rate base." 320 U.S. at 605. Duquesne Light Company continues to operate successfully, has maintained its financial integrity, its ability to attract capital and has sufficiently compensated its investors after the Pennsylvania Supreme Court disallowed a return of and on its prudent investment in cancelled generating plant. Therefore, all tests as stated in *Hope* have been met and this Court should refrain from establishing an additional constitutional entitlement for those utility investors to recover all prudent investment automatically without a treatment of the other factors stated in *Hope*.[9]

While the *Hope* court established the above criteria, it did not reject the used and useful doctrine or forbid its use by states or their ratemaking agencies when balancing the interests of utility ratepayers and investors. Contrary to the assertions of the amici supporting the Appellants, the "used and useful" doctrine did not disappear or become unnecessary as a result of *Hope*. It remained as a valid criteria for each state and each ratemaking agency to consider when performing the balancing of interests mandated by *Hope*. The lower federal and state courts have continued to apply the used and useful doctrine and this Court continues to dismiss appeals challenging its constitutionality. *See* Part II below.

Similarly, in the *Permian Basin Area Rate Cases*, cited so favorably by the Appellants and the supporting amici, this Court never rejected the concept of the used and useful principle. The Court merely clarified and elaborated upon the *Hope* end result test by stating that the reviewing court must determine whether the rate order may be reasonably expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the *relevant public inter-*

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[9] The other Appellant, Pennsylvania Power Company (Penn Power), was authorized to charge a 15.72% return on common equity, a 12.02% overall return on rate base, and received a $15.4 Million annual base rate increase bringing its total annual revenues in excess of $184 Million. The Pennsylvania Supreme Court's denial of the annual amortization claim for the cancelled plants at issue amounted to only $957,000. Despite the Pennsylvania Supreme Court's order, Penn Power has continued to operate successfully, has maintained its financial integrity, and its ability to attract capital.

ests, both existing and foreseeable. 390 U.S. at 792 (emphasis added).

Section 1315 of the Code and the Supreme Court of Pennsylvania's interpretation thereof allowed for consideration of the present and the future public interest. Rather than signalling to the regulated utility that *any* prudent investment would produce a return of and on that investment regardless of whether the investment ever served the public, the Pennsylvania Supreme Court chose to protect present and future ratepayers from such an unwarranted constitutional entitlement. However, the Pennsylvania Supreme Court did assure the Appellants through other adjustments in its ratemaking process the ability to attract necessary capital, maintain its financial integrity and fairly compensate the utility investors for the risks they had assumed. The fact that one particular investment never produced used and useful public utility property and the Court's denial of a return of and on that investment did not so damage the Appellants that they could not continue to operate successfully. No case ever decided by this Court or the lower federal courts have bestowed a constitutional right for utility investors to recover a return of and on any prudent investment without consideration of any other factors.

Denver Union Stock Yard Co. v. U.S., 304 U.S. 470 (1938), established the boundaries of a utility investor's right to recover costs in a specific investment. The Court stated that the due process clause of the Fifth Amendment assures utility investors rates which are sufficient to yield a reasonable rate of return on the value of property used, at the time it is being used, to render the services, but such rates cannot be per se excessive and extortionate. 304 U.S. at 475. However, the Court cautioned that the regulated entity is not entitled to have included any property not "used and useful" for that purpose. *Id.* Just as the Court refrained from creating an additional constitutional right to the return of or on

all prudent utility investment in the *Denver Union Stock Yard* case, so should the Court refrain from conferring such a substantial constitutional entitlement on the Appellants in this case.

The establishment of the used and useful principle in the *Denver Union Stock Yard* case confirmed an extended series of cases, all of which specifically refrained from unreasonably expanding the constitutional entitlements of utility investors. *See Smyth v. Ames*, 169 U.S. 466 (1898); *Willcox v. Consolidated Gas Co.*, 212 U.S. 19 (1909); *Minnesota Rate Cases*, 230 U.S. 352 (1913); *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n*, 262 U.S. 679 (1923); *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23 (1926); *Los Angeles Gas Corp. v. Railroad Commission*, 289 U.S. 287 (1933); *St. Joseph Stock Yards Co. v. U.S.*, 298 U.S. 38 (1936).

The lower federal courts have not chosen to expand the interpretation of this extended line of cases based upon the Court's teachings in *Hope* and *Permian*. The novel arguments raised by Appellants and the amici have not been adopted by any court of which IECPA, ELCON or AISI are aware. The used and useful principle "has stood as a bedrock principle of utility rate regulation for nearly a century" and should not be struck down by the Court in a thinly veiled attempt, by the Appellants and amici supporting the Appellants, to create a constitutional entitlement to a return of or on every dollar invested by regulated utilities without respect to whether ratepayers are ever provided with any benefit from that investment. *Kentucky Utilities Co. v. FERC*, 760 F.2d 1321, 1324 n.4 (D.C. Cir. 1985). States must retain the discretion of employing the used and useful principle on a case-by-case basis to decide whether a proper balancing of ratepayer and shareholder interests requires or does not require a return of or on prudent investment. Otherwise, current ratepayers would bear more than the legitimate costs of providing service to them.

The result sought by Appellants would be inconsistent with the United States Court of Appeals for the District of Columbia decision in *Natural Gas Pipeline Co. v. FERC*, 765 F.2d 1155, 1157 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 794 (1986). That decision characterized the "used and useful" principle as a "bedrock" of utility regulation. It capsulized the principle as simply requiring that costs associated with electric power plants be paid by the ratepayers who benefit from the plant. 760 F.2d at 1324, fn.4. Ratepayers of the Appellants in this proceeding will never benefit from the investments in the cancelled nuclear plants in question and thus should not be constitutionally required to bear the cost responsibility of those investments.

The United States Court of Appeals for the District of Columbia Circuit most recently addressed the constitutional issues raised by the Appellants in *Jersey Central Power & Light Co. v. Federal Energy Regulatory Commission*, 810 F.2d 1168 (D.C. Cir. 1987) and confirmed the constitutionality of employing the used and useful test. After an extensive review of the standards established in *Hope* and *Permian Basin*, the court characterized those teachings as "straightforward". *Id.* at 1177. In reviewing rate orders, the courts must determine whether or not the end result of such orders constitute a reasonable balancing, based on factual findings, of the investor interests in maintaining financial integrity and access to capital markets and the consumer interest in being charged nonexploitative rates. *Id.* at 1177-1178. While the court concluded in *Jersey Central* that it was impossible to answer the question of whether including the unamortized portion of cancelled plant in rate base would exploit consumers in that case, or whether its exclusion, on the facts in the case, constituted confiscation from the utility, such a determination of the "central point" can be made in the case which is the subject of this appeal. *Id.* at 1181. The court specifically stated, "the Commission is not precluded from employing 'used and useful' or any other specific rate setting formula" and the case was only remanded to the Federal Energy Regulatory Commission because no hearing had been held consistent with this Court's directives in *Hope* and *Permian Basin*. The *Jersey Central* court went on to require the Commission to ensure that the resulting rate is just and reasonable. *Id.* at 1187.

The *Jersey Central* decision is also instructive on the issue of what constitutes an unconstitutional taking of utility investor property. In his concurring opinion, Judge Starr indicated that such a taking occurs only when a regulated rate is confiscatory, which is a shorthand way of saying that an unreasonable balance has been struck in the regulation process so as unreasonably to favor ratepayer interests at the substantial expense of investor interests.

> Thus, in my view, a taking does not occur when financial resources are committed to the enterprise. That is especially so since the utility's capital investment is made not simply in satisfaction of legal obligations to provide service to the public, but in anticipation of profits on the investment. The utility is not a servant to the state; it is a for-profit enterprise which incurs legal obligations in exchange for state-conferred benefits. A profit-seeking capital investment is scarcely the sort of deprivation of possession, use, enjoyment, and ownership of property which can conceptually be deemed a taking. *Id.* at 1189.

This Court should not now depart from its decisions in *Hope* and *Permian Basin* as interpreted by the lower federal courts in each of the proceedings discussed above. No need exists for the establishment of a constitutional entitlement in each and every utility investor to recover a return of or on all prudent investments without regard to the used and useful nature of those investments in providing public utility service.

II. This Court Has Regularly Dismissed Proceedings Which Have Raised The Identical Constitutional Arguments Made By Appellants In This Case.

This Court's dismissal of comparable proceedings applying the used and useful principle indicates it was not overridden by *Hope* and that a utility investor's alleged right to the recovery of or on all prudent investments is not of constitutional dimension.

Through a dismissal for want of a substantial federal question, this Court has refused to reverse decisions on the merits upholding Pennsylvania's and other states' denial of cost recovery on utility investment in nuclear power plants out of service for an extended period due to a nuclear accident. *Pennsylvania Electric Co. v. Pennsylvania Public Utility Comm'n*, 509 Pa. 324, 502 A.2d 130 (1985), *appeal dismissed sub nom. Metropolitan Edison Co. v. Pennsylvania Public Utility Comm'n*, 476 U.S. 1137 (1986). *See also Jersey Central Power & Light Co. v. Board of Public Utilities*, 466 U.S. 947 (1984). The Court dismissed several other cases, some of which involved the same cancelled nuclear plants subject to this case. *Cleveland Electric Illuminating Co. v. Public Utilities Comm'n*, 4 Ohio St.3d 107, 447 N.E.2d 746, *appeal dismissed*, 464 U.S. 802 (1983); *Cleveland Electric Illuminating Co. v. Public Utilities Comm'n*, No. 82-165 (Ohio, July 7, 1982), *appeal dismissed*, 459 U.S. 1094 (1983); *Office of Consumers' Counsel v. Public Utilities Comm'n*, 67 Ohio St.2d 153, 423 N.E.2d 820 (1981), *appeal dismissed sub nom., Cleveland Electric Illuminating Co. v. Office of Consumers' Counsel*, 455 U.S. 914 (1982); *Northern Indiana Public Service Co. v. Citizens Action Coalition of Indiana, Inc.*, 485 N.E.2d 610 (Ind. 1985), *appeal dismissed and cert. denied*, 476 U.S. 1137 (1986). These decisions confirm that *Hope* did not reverse or override the application of the used and useful principle.

The decision by the Pennsylvania Supreme Court to deny the Appellants a return of and on its investment

in the subject cancelled nuclear power plants was not unique. The highest state court in Ohio reached an identical result under its own public utility law and this Court has dismissed three separate appeals which argued that the denial of such cost recovery represented an unconstitutional confiscation of property. One of those dismissals, *Cleveland Electric Illuminating Co. v. Public Utilities Comm'n*, 4 Ohio St.3d 107, 447 N.E.2d 746, *appeal dismissed*, 464 U.S. 802 (1983) was for want of a substantial federal question, thus, constituting a decision on the merits. *See Meek v. Pittenger*, 421 U.S. 349, 367 N. 16 (1975). The Court dismissed two other appeals for lack of jurisdiction or lack of a properly presented federal question in *Cleveland Electric Illuminating Co. v. Public Utilities Comm'n*, No. 82-165 (Ohio, July 7, 1982), *appeal dismissed*, 459 U.S. 1094 (1983), and in *Office of Consumers' Counsel v. Public Utilities Comm'n*, 67 Ohio St.2d 153, 423 N.E.2d 820 (1981), *appeal dismissed sub nom., Cleveland Electric Illuminating Co. v. Office of Consumers' Counsel*, 455 U.S. 914 (1982). This Court most recently dismissed an appeal from the highest court of the state of Indiana also addressing the denial of recovery of cancelled plant costs. *See Northern Indiana Public Service Co. v. Citizens Action Coalition of Indiana, Inc.*, 485 N.E.2d 610 (Ind. 1985), *appeal dismissed* and *cert. denied*, 476 U.S. 1137 (1986).

The Court's action in these cases confirms that the used and useful principle of utility regulation has a continuing place in assuring utility's ratepayers that their interests are properly balanced with those of the utility's investors. Absent the used and useful principle, the balance swings unconscionably to the side of the utility investor and would result in ratepayers being required to absorb the cost of any and all prudent investment made by the utilities regardless of whether that investment ever provides any benefit to ratepayers.

CONCLUSION

The Fifth and Fourteenth Amendments do *not* constitutionally require states to allow recovery of or on prudently incurred investments, including, but not limited to, cancelled electric generating units without a consideration of whether those investments constitute used and useful utility property. The Court should reject the Appellants' contention that a prudence-only standard is required by the *Hope* and *Permian Basin* cases. In order for states to properly balance the interests of utility investors against utility ratepayers consistent with the directives of *Hope* and *Permian*, the used and useful principle must be continued for ratepayers' protection. The balancing requirements of *Hope* and *Permian* necessitate state discretion on a case-by-case basis to deny or to allow a return of or on prudent investment based on all the facts presented.

In any case, this Court should refrain from creating an additional constitutional entitlement to utility investors which is not available to investors in the private competitive marketplace. If the system of regulation is to operate appropriately as a mirror of the competitive marketplace, utility investors must expect to bear an appropriate portion of the business risk inherent in prudent managerial decisions regarding plant construction. These risks include the possibility of making a prudent investment which never produces economic benefits for ratepayers nor used and useful utility property. In such events, a state must have the discretion of pursuing the appropriate balancing of interests between the investor and the ratepaper by denying recovery of or on property which is not used and useful for customer service. Such denial does not confiscate constitutionally protected property interests since the loss of value of the investment for which recovery is denied results from action of the free market rather than state regulation. The utilities are not denied any recovery which they

would have received in a competitive market. Therefore, Section 1315 of the Pennsylvania Public Utility Code and the "unspecified ratemaking legislation" must be upheld by this Court as being consistent with the Constitution and this Court's precedents in *Hope* and *Permian Basin*.

Respectfully submitted,

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